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SUBJECT: UPDATE ON ENERGY ISSUES FROM SERBIA

REF: Belgrade 2062

SUMMARY

11. (SBU) Several major energy issues are still on the front burner as Serbia's democratic parties work to assemble a new government. Srbijagas's general director recently announced that Gazprom is likely to be Srbijagas's strategic partner in providing natural gas for the underground storage facility in Banatski Dvor. This comes on the heels of the December 21 signing of a Memorandum of Understanding for a possible extension of the Blue Stream gas pipeline through Serbia, as well as the signing of a new gas supply deal with Yugorosgaz, a shady Gazprom-linked company with its origin in the Milosevic era (reftel). However, Slobodan Sokolovic, assistant minister for energy, downplayed the significance of these developments in a January 18 meeting, asserting that only a new government can take action on such major issues. End Summary

STRATEGIC PARTNER(S) FOR BANATSKI DVOR

12. (U) Milos Milankovic, general director of state-owned gas company Srbijagas, said on January 10 that Srbijagas would first talk with its "strategic partner," Gazprom, on the possible filling of the Banatski Dvor gas storage facility. Milankovic said with Srbijagas completing the first phase of construction, time and money is critical. To use the gas storage during the 2007/08 winter season, Srbijagas needs USD 50 million to pump in around one million cubic meters of gas per day in the period April-October 2007 to provide the needed cushion gas. However, Milankovic said that Srbijagas also is ready to work with other potential partners who may have interest in using gas from Banatski Dvor, such as city authorities, district heating power plants, or companies that are major consumers of gas (such as U.S. Steel). (Note: Milankovic stood as a Parliamentary candidate on the G17 list; given the practice of dividing key jobs at major state-owned companies among coalition parties, he may well be out of the job soon.)

13. (SBU) Slobodan Sokolovic, assistant minister for gas and oil, told econ chief on January 18 that Srbijagas, as a state-owned company, must have the permission of the Ministry of Energy and Mining for any major action. According to Sokolovic, long-term plans call for doubling the capacity of Banatski Dvor in Serbia (the maximum capacity is 850 million cubic meters) and negotiating with Romania and Bulgaria on managing such storage in accordance with European energy security policy. Sokolovic noted that Serbia's storage capacity could supply gas not only to the domestic market but to the region as well. (Note: Some sources estimate that Serbia could store as much as 7 billion cubic meters in underground gas storage.)

14. (SBU) Milankovic, in a later conversation following up on his

public remarks, said that, in theory, a tender would be the best option to find a partner on the gas storage project, but Serbia's dependence on Gazprom also must be taken into consideration. Sokolovic confirmed that a tender was an option but also mentioned the need to form a strategic partnership with potential suppliers and major consumers, as well. He welcomed any proposal on how to accomplish such a goal.

¶15. (SBU) Gazprom's interest in the gas storage was confirmed by Vladimir Koldin, director of Yugorosgaz, in a January 12 meeting. Koldin, a Russian, was notably close-mouthed in discussing Yugorosgaz activities, but he did express interest in the gas storage project, noting that such storage offers the ability to balance between the peaks and valleys of winter-summer consumption.

NIS-DIMITROGRAD GAS PIPELINE

¶16. (U) Milutin Prodanovic, assistant minister for public enterprises at the energy ministry, said in an early January press interview that that Srbijagas would begin construction of a gas pipeline on the Nis-Dimitrovgrad route to provide Serbia with an alternative gas source via Bulgaria. Such a project is a high priority, both to provide additional security via an alternative to the MOL pipeline, and to give Serbia leverage in negotiations with the Hungarians over transmission fees. However, Prodanovic did not predict when construction could begin.

¶17. (U) However, the Memorandum of Understanding (MOU) recently signed between Srbijagas and Gazprom projects using the same route to extend the Blue Stream gas pipeline through Serbia, raising the question of which pipeline will be built, and when. Sokolovic said that Serbia had a MOU with Bulgaria for connection of the two gas systems, but it has not been decided yet whether to proceed with a local pipeline of 3 billion cubic meters capacity, a transit pipeline of more than 20 billion cubic meters, or even parallel pipelines.

¶18. (SBU) Sokolovic emphasized that the gas transit MOU with Gazprom is only an expression of interest among the three parties. A joint working group - the leader of which will be Gazprom - will analyze the feasibility of all aspects of the project and submit a report by July 2007. Sokolovic declined to provide a copy of the MOU, claiming that he cannot release it without the permission of all parties.

YUGOROSGAZ INTERMEDIATES GAS SUPPLY

¶19. (SBU) Koldin, of Yugorosgaz, a joint venture of Gazprom and Srbijagas controlled by Gazprom, confirmed that Yugorosgaz is a party to the transit MOU, but declined to be more specific. He also confirmed that Yugorosgaz is now the supplier of gas to Serbia for ¶2007. Koldin would only say that the price is similar to Serbia's past pricing, but other sources told us it is USD 256 per thousand cubic meters. Sokolovic said that it is a one-year contract.

¶10. (SBU) Yugorosgaz has been active in building pipelines in southern Serbia. It already has constructed a 60-mile pipeline south from Paracin to Nis, and it has announced an agreement to extend the pipeline to Vranje. Koldin told us that they are in talks with Philip Morris in Nis to provide the cigarette manufacturer with gas. On January 17, ministry official Prodanovic said that Yugorosgaz has an obligation to build all the main gas pipelines in Serbia south of Nis through 2021, in accordance with the two agreements between former Federal Republic of Yugoslavia and Russia from 1996.

¶11. (SBU) In the January 18 meeting, econ chief asked Sokolovic why Srbijagas had elected to sign a deal with Yugorosgaz, as opposed to Gazprom. Sokolovic said that Gazprom had dictated that Yugorosgaz be the supplier and also had insisted on signing the deal before signature of the MOU on a potential gas transit pipeline.

NIS PRIVATIZATION

¶12. (SBU) Sokolovic dismissed press reports that the GOS is negotiating with Russian Rosneft about recapitalization of oil company Naftna Industrije Srbije (NIS); to the contrary, Sokolovic said, Rosneft is in the middle of an IPO and had shown no interest.

He also denied press speculation that the NIS privatization tender would be restarted before a new government is formed, explaining that most likely the new government will take up the privatization. At the same time, he said that both he and Minister Naumov would like to see the tender re-opened as soon as possible using the approach already laid down by the previous government.

¶13. (SBU) COMMENT: The Yugorosgaz - or Gazprom - interest in Serbia's gas storage is not surprising. Gas storage can serve consumers' interests by allowing them to stockpile off-peak gas and provide a margin of security against disruption in the transit system. At the same time, such storage could serve Gazprom's interest by permitting it to stockpile gas nearer consumers, to offset the danger of supply disruption as gas transits through third countries. Sokolovic clearly favors a transparent system in which both consumers and producers have a stake; we hope to see Serbia's energy ministry steer policy in this direction under a new government. End Comment.
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